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Supreme Court, U.S.
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No. 94-18

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

Antonio C. Mastrobuono and Diana G. Mastrobuono,

Petitioners,

v.

Shearson Lehman Hutton Inc., a corporation, and Nick DiMinico,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR PETITIONERS

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85 pp

QUESTIONS PRESENTED

1. Whether the Seventh Circuit erred in holding that the law of a state named in a choice-of-law provision, rather than the Federal Arbitration Act, governs the arbitrability of a claim for punitive damages arising out of a contract which evidences a transaction involving commerce and which contains a comprehensive arbitration clause.

2. Whether the Seventh Circuit erred in holding that a party to a contract containing a comprehensive arbitration clause waives the right to recover punitive damages in any forum where the contract also includes a provision that the agreement is governed by the law of a state which does not permit arbitral awards of punitive damages.

LIST OF PARTIES

Petitioners:

Antonio C. Mastrobuono

Diana G. Mastrobuono

Respondents:

Lehman Brothers Inc. (Lehman Brothers Inc. is the successor corporation to the corporation that was formerly known as Shearson Lehman Hutton Inc.).[1]

Nick DiMinico

Richard F. Benzer and Mark Stevenson who were previously named as Respondents in the caption of the Petition For Writ Of Certiorari, Respondents' Brief In Opposition and Reply Brief For Petitioners, appeared in the caption of

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[1] Pursuant to Supreme Court Rule 29.1, the Court is advised that the parent company of Lehman Brothers Inc. is Lehman Brothers Holdings Inc. Lehman Brothers Inc. has no subsidiaries except those which are wholly owned subsidiaries.

the case in the proceedings before the Court of Appeals but were not parties to those proceedings and are not parties herein. Accordingly, they have been eliminated from the caption of the case in this Court.

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BRIEF FOR PETITIONERS

CITATIONS TO OPINIONS BELOW

The decision of the Court of Appeals for the Seventh Circuit (hereinafter the "Seventh Circuit") is reported at 20 F.3d

713 (1994), and is reprinted in full in the Appendix to the Petition For Writ Of Certiorari at App. 1 - App. 27.

The Order of the United States District Court for the Northern District of Illinois (the Honorable Charles Norgle) is reported at 812 F.Supp. 845 (N.D. Ill. 1993), and is reprinted in full in the Appendix to the Petition For Writ Of Certiorari at App. 28 - App. 43.

STATEMENT OF JURISDICTION

Petitioners seek review of the decision of the Seventh Circuit entered on March 30, 1994, affirming the District Court's Order vacating an arbitral award of punitive damages in favor of petitioners and denying petitioners' motion, in the alternative, for a trial on the amount of petitioners' punitive damages claims to be awarded on the

arbitrators' finding that they were entitled to punitive damages or, in the further alternative, for a trial on the state statutory and common law claims giving rise to petitioners' claim for punitive damages.

Jurisdiction is conferred upon this Court to review the March 30, 1994 judgment of the Seventh Circuit by 28 U.S.C. §1254(1). The Petition For Writ Of Certiorari was timely filed on June 28, 1994 and, on October 7, 1994, this Court granted certiorari.

STATUTE INVOLVED

The relevant text of 9 U.S.C. §§ 2, 3, 4 and 10 is set forth in the Appendix hereto at App. 1 - App. 4.

STATEMENT OF THE CASE

In October, 1985, respondent Nick DiMinico (hereinafter at times

"DiMinico"), a licensed representative and vice-president of respondent Shearson Lehman Hutton Inc. (hereinafter at times "Shearson"), solicited petitioners, Antonio and Diana Mastrobuono (hereinafter at times "the Mastrobuonos"), to open a securities trading account with Shearson. (Memo. In Opposition to *Vacatur* Petition, pp. 1-2, Docket No. 81). At that time, Antonio Mastrobuono was an assistant professor of Medieval Literature at the University of Illinois at Chicago and his wife, Diana, was an artist and homemaker. DiMinico had been Antonio Mastrobuono's student and had become personal friends of the Mastrobuonos. The Mastrobuonos explained to DiMinico that the money they were giving him to invest represented all of their money and that they intended to use the money to purchase a home in the

Chicago area and to pay for their children's education. In light of this, the money was to be invested with safety and income as the only objectives. (Memo. In Opposition to *Vacatur* Petition, Exhibit D - Amended Statement Of Claim, Docket No. 81; Brief And Appendix Of Appellants, pp. 1-2). In connection with opening their account, the Mastrobuonos executed Shearson's standard form Client's Agreement. (Memo. In Opposition to *Vacatur* Petition, Exhibit A, Docket No. 81).

Paragraph 13 of the Client's Agreement provided, in relevant part:

> This agreement ... shall be governed by the laws of the State of New York. Unless unenforceable due to federal or state law, any controversy arising out of or relating to my accounts, to transactions with you, your officers, directors, agents and/or employees for me or to this agreement or the

> breach thereof, shall be settled by arbitration in accordance with the rules then in effect, of the National Association of Securities Dealers, Inc. or the Board of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchange Inc. as I may elect.... (Memo. In Opposition to *Vacatur* Petition, Exhibit A - Client's Agreement, Docket No. 81; Pet. App. at 44).

DiMinico serviced the Mastrobuonos' account and, during the course of his handling of the account, engaged in various forms of misconduct, including unauthorized trading and churning. In 1987, after incurring substantial losses, the Mastrobuonos closed their account. (See Memo. In Opposition to *Vacatur* Petition, Exhibit D - Amended Statement of Claim, and Exhibit E - N.A.S.D. Award, Docket No. 81).

In January, 1989, the Mastrobuonos filed suit in the United States District Court for the Northern District of

Illinois, alleging that Shearson and DiMinico had subjected their account to unauthorized trading, churning and margin exposure. In their Complaint, the Mastrobuonos invoked the jurisdiction of the District Court pursuant to 28 U.S.C. §1331 (federal question) over their claims pursuant to the Securities Exchange Act of 1934 and the Racketeer Influenced and Corrupt Organizations Act ("RICO"), and its pendent (supplemental) jurisdiction over their claims based on the Illinois Securities Law, Illinois Consumer Fraud and Deceptive Business Practices Act and common law claims for breach of contract, breach of fiduciary duty, fraud, misrepresentation, and negligence. In their prayer for relief, the Mastrobuonos sought compensatory damages, attorneys' fees and costs, treble damages under the

RICO claim and punitive damages under the Illinois statutory and common law claims. (Complaint, Docket No. 1).

In April, 1989, respondents moved, pursuant to §§ 3 and 4 of the Federal Arbitration Act (hereinafter "FAA"), to stay the District Court proceedings and to compel arbitration before the National Association of Securities Dealers (hereinafter "NASD"). (Defendants' Motion To Stay Proceedings And To Compel Arbitration, Docket No. 22). The District Court granted the motion. (8/2/89 Minute Order, Docket No. 38).

The Mastrobuonos filed their Statement of Claim on October 20, 1989, and their Amended Statement of Claim on September 16, 1991. (Memo. In Opposition to *Vacatur* Petition, Exhibit E - N.A.S.D. Award, Docket No. 81). In their Amended

Statement Of Claim, the Mastrobuonos stated claims based on violation of the NASD Rules of Fair Practice, SEC Rule 10b-5, §15(c)(1) of the Securities Exchange Act, the Illinois Consumer Fraud Act, the Texas Deceptive Trade Practices-Consumer Protection Act, and common law claims for breach of fiduciary duty and negligence. The Mastrobuonos requested compensatory and punitive damages, as well as treble damages under the Texas Deceptive Trade Practices-Consumer Protection Act. (Memo. In Opposition to *Vacatur* Petition, Exhibit D - Amended Statement of Claim, Docket No. 81). The arbitration hearings took place before a panel of three arbitrators on August 11 and 12, 1992, and September 29, 1992, in Chicago, Illinois. On September 29, 1992, respondents asserted for the first time that the arbitrators lacked the

authority to award punitive damages, submitting their Respondents' Memorandum Regarding Claim For Punitive Damages to the arbitration panel. (Motion to Partially Vacate Arbitration Award, p. 2, para. 4, Docket No. 58; Knepper Affidavit, Exhibit B, Docket No. 59). The Mastrobuonos were given leave to respond and thereafter submitted their Brief In Opposition to Punitive Damages. (Knepper Affidavit, Exhibit C, Docket No. 59).

On October 13, 1992, the arbitrators awarded the Mastrobuonos compensatory damages in the amount of $159,327.00 ($115,274.00 in commissions and $44,053.00 in margin interest) and punitive damages in the amount of $400,000.00. (Memo. In Opposition to *Vacatur* Petition, Exhibit E - N.A.S.D. Award, Docket No. 81).

Respondents did not contest and subsequently paid the compensatory damages award but moved in the District Court, pursuant to 9 U.S.C. §10(a)(4), to vacate the award of punitive damages. Respondents argued that New York law, the law governing the Client's Agreement, prohibits arbitrators from awarding punitive damages. (Motion To Partially Vacate Arbitration Award, Docket No. 58; Memo. of Law in Support of Motion to Partially Vacate Arbitration Award, Docket No. 60). The Mastrobuonos moved for confirmation of the arbitration award or, in the alternative, for a trial on the amount of punitive damages to be awarded on the arbitrators' finding that the Mastrobuonos were entitled to punitive damages or, in the further alternative, for a trial on the state statutory and

common law claims giving rise to their claim for punitive damages. (Motion For Confirmation Of Arbitration Award And Entry Of Judgment Thereon; Or In The Alternative to Set A Date For Trial On Amount Of Punitive Damages to Be Awarded On Arbitrators' Finding That Plaintiffs Are Entitled To Punitive Damages; Or In The Further Alternative To Set A Trial Date On Plaintiffs' Pending Claims For Punitive Damages For Defendants' Negligence, Fraud, Breach Of Fiduciary Duty And Violations Of The Illinois And Texas Consumer Fraud Acts, Docket No. 68). The District Court granted respondents' motion, vacating the punitive damages award, and denied the Mastrobuonos' motion in its entirety. (2/9/93 Order, Docket No. 79; Pet. App. at 28-43).

On appeal, the Seventh Circuit affirmed the decision of the District Court, confirming the District Court's finding that the arbitrators had exceeded their power by awarding punitive damages. (Opinion of the Court of Appeals for the Seventh Circuit, Docket No. 92; Pet. App. at 1-27).

SUMMARY OF THE ARGUMENT

1. In this case the Seventh Circuit held that by entering into a customer agreement with a securities dealer which contained a New York choice-of-law provision and a comprehensive arbitration clause, the Mastrobuonos had agreed to accept a New York common law rule against arbitral awards of punitive damages and had thereby surrendered any claim for punitive damages. The decisions of this Court, however, have conclusively

established that, with regard to agreements which fall within the purview of the Federal Arbitration Act ("FAA"), state law hostile to arbitration has been preempted. The decisions of this Court have consistently found that state law which obstructs the "liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary" must yield to federal law. *See Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983). Consistent with this policy, this Court has repeatedly found various state statutes and common law rules preempted by the FAA and has upheld only state procedural rules which are "manifestly designed to encourage resort to the arbitral process." *Volt*

Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior University, 489 U.S. 468, 476, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989).

The New York prohibition against arbitral awards of punitive damages cannot be reconciled with the federal substantive law of arbitrability and, in fact, represents the views of arbitration as an inferior and inappropriate means of dispute resolution which Congress expressly sought to overcome by enacting the FAA. The decision of the Seventh Circuit, however, serves to resurrect and enforce, as a matter of federal law, longstanding judicial prejudices against arbitration by construing contracts containing comprehensive arbitration clauses and state choice-of-law clauses to incorporate state law founded on those

prejudices. Accordingly, the Seventh Circuit's decision in this case must be reversed.

2. The Seventh Circuit's decision is even more deeply flawed because the court determined not just that the Mastrobuonos were not entitled to an arbitral forum for resolution of their punitive damages claim but that they were not entitled to *any* forum for resolution of those claims. The Seventh Circuit concluded that by agreeing to a choice-of-forum clause and a choice-of-law clause, the Mastrobuonos had waived any claim to punitive damages in any forum. In this way, the Seventh Circuit's decision disregards the concept of waiver as a voluntary relinquishment of a known right and construes the contract at issue in a manner which this Court has previously

indicated would render the contract unconscionable. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 637, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985).

ARGUMENT

I.

THE FAA PREEMPTS STATE LAW PROHIBITIONS AGAINST ARBITRAL AWARDS OF PUNITIVE DAMAGES.

In seeking to elucidate the scope and impact of the Federal Arbitration Act ("FAA), this Court has consistently held that, under the Supremacy Clause, the FAA preempts state law where it undermines the Congressional intent underlying enactment of the FAA. In enacting the FAA, Congress sought to place arbitration agreements "upon the same footing as other contracts" and to overcome, by legislative enactment, the judiciary's longstanding refusal to

enforce arbitration agreements arising out of "an anachronism in American law" derived from "the jealousy of the English courts for their own jurisdiction." See *Dean Witter Reynolds Inv. v. Byrd,* 470 U.S. 213, 219-220, 105 S.Ct. 1238, 84 L.Ed.2d 158 (1985), quoting from H.R. Rep. No. 96, 68th Cong., 1st Sess., 1-2 (1924).

For example, in its decision in *Prima Paint Corp. v. Flood Conklin Mfg. Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270 (1967), the Court considered whether a claim of "fraud in the inducement" of a contract, which contained a broad arbitration clause, was to be decided in a judicial or arbitral forum, where there was "no evidence that the contracting parties intended to withhold that issue from arbitration." *Prima Paint,* 87 S.Ct at 1802. The Court concluded that an

arbitration clause is severable from the agreement which contains it and that, unless the allegation of "fraud in the inducement" goes specifically to the making of the arbitration agreement, rather than the contract as a whole, such claims are to be determined in arbitration. In reaching its decision, the Court resolved a conflict among the Circuits, upholding the view that, except where the parties otherwise intend, as a matter of federal law arbitration clauses are severable from the contracts in which they are contained. The Court rejected the view that the question of "severability" is one of state law and that where a state regards an arbitration clause as "inseparable" a claim of fraud in the inducement of the contract must be

decided by the courts. See *Prima Paint*, 388 U.S. at 403-404.

Subsequently, in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), the Court more explicitly addressed the preemption issue, explaining:

> Section 2 [of the FAA] is the primary substantive provision of the Act, declaring that a written agreement to arbitrate "in any maritime transaction or a contract evidencing a transaction involving commerce...shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. §2. Section 2 is a congressional declaration of a liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to the contrary*. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the

> coverage of the Act. *Moses H. Cone*, 460 U.S. at 24. [Footnote omitted; emphasis added.]

The Court further stated:

> The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation or waiver, delay, or a like defense to arbitrability. *Moses H. Cone*, 460 U.S. at 24-25. [Footnote omitted.]

This Court has consistently relied upon these principles in determining that state law hostile to arbitration is preempted by the FAA. In *Southland Corp. v. Keating*, 465 U.S. 1, 104 S.Ct. 852, 79 L.Ed.2d 1 (1984), the Court addressed whether the FAA preempted a provision of the California Franchise Investment Law. The California Supreme Court had interpreted a provision of that statute to

require judicial consideration of claims brought under the statute and had concluded that the statute did not contravene the FAA. This Court reversed, finding that this construction of the California law directly conflicted with §2 of the FAA and therefore violated the Supremacy Clause. The Court ruled that the parties were required to arbitrate a dispute arising under a franchise agreement which contained a broad arbitration clause, notwithstanding the contrary state law provision. In reaching its decision, the Court reviewed the problems which Congress sought to obviate by passage of the FAA, reaffirmed its holdings in *Prima Paint* and *Moses H. Cone*, and made clear that the FAA creates a body of substantive federal law, enacted pursuant to Congress' authority under the

Commerce Clause, which is applicable both in state and federal courts. As the Court stated:

> In enacting §2 of the federal Act, Congress declared a national policy favoring arbitration and *withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties have agreed to arbitrate. Keating*, 465 U.S. at 10. [Emphasis added.]

Similarly, in *Perry v. Thomas*, 482 U.S. 483, 107 S.Ct. 2520, 96 L.Ed.2d 426 (1987), the Court considered whether the Federal Arbitration Act preempted a section of the California Labor Code which provided that actions for the collection of wages could be maintained "without regard to the existence of any private agreement to arbitrate." *Perry*, 482 U.S. at 484, quoting from Cal.Lab.Code Ann. §229 (West 1971). In *Perry*, the plaintiff brought suit in the California Superior

Court against his former employer, Kiddy Peabody & Co., and two of its employees to recover commissions allegedly due to him on the sale of securities, as well as compensatory and punitive damages. Defendants sought to compel arbitration under §§ 2 and 4 of the FAA, based on an agreement plaintiff had signed as part of his application for employment, by which he had agreed to submit to arbitration any dispute arising between himself and his firm, customers and or any other persons. Plaintiff resisted defendants' attempts to compel arbitration, asserting that the California Labor Code authorized his state court action, notwithstanding the agreement to arbitrate. The Court concluded that the California statute requiring that litigants be provided a judicial forum for resolving wage disputes

clearly conflicted with the federal policy of rigorous enforcement of arbitration agreements and that, under the Supremacy Clause, the California state statute "must give way." *Perry*, 482 U.S. at 491.

In a concurrent line of cases, including *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 105 S.Ct. 3346, 87 L.Ed.2d 444 (1985), and *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), the Court further addressed the scope of the FAA, making clear that, as a matter of federal law, the parties may agree to arbitrate federal statutory claims even where those claims give rise to punitive-type remedies. In *Mitsubishi Motors*, the Court concluded that a claim based on the Sherman Act was arbitrable, where the parties' agreement

arose from an international transaction. In reaching its decision, the Court stated:

> [T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute. The court is to make this determination by applying the "federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act." *Mitsubishi Motors*, 473 U.S. at 626. [Citations omitted.]

Reiterating that portion of its decision in *Moses H. Cone* wherein it held that doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, the Court stated, "Thus, as with any other contract, the parties' intentions control, but those intentions are generously construed as to issues of arbitrability." *Mitsubishi Motors*, 473 U.S. at 626. The Court found that the

agreement to arbitrate encompassed the statutory claims and that various considerations relating to an international transaction required enforcement of the parties' agreement, even if, in a domestic context, other policy considerations might preclude arbitration. The Court reached this decision, notwithstanding the important role of private enforcement contemplated under the Sherman Act, as evidenced by the availability of treble damages for violations of the Act. The Court noted that the Sherman Act's treble damages provision served both a remedial and a deterrent function, and that these functions were not circumvented by its decision. See *Mitsubishi Motors*, 473 U.S. at 636-637.

Specifically in the domestic context, in *McMahon* the Court considered whether, pursuant to a predispute arbitration agreement between a brokerage firm and its customers, claims brought pursuant to the Securities Exchange Act of 1934 and Racketeer Influenced and Corrupt Organizations Act must be arbitrated in accordance with the terms of the agreement. The Court commenced its analysis with a review of its prior decisions emphasizing the federal policy favoring arbitration. The Court concluded that both the Exchange Act and RICO claims were arbitrable, noting that the mistrust of the arbitral forum articulated in its prior decision in *Wilko v. Swan,* 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed.2d 168 (1953), was difficult to reconcile with the Court's subsequent assessments of the

arbitral forum, and also that the concerns stated in *Wilko* had been obviated by the fact that, since the time of that decision, the Exchange Act had been amended to give the SEC expansive power to ensure the adequacy of the arbitration procedures employed by the national securities exchanges and registered securities associations.[2] With regard to the RICO claim, the Court stated that the primary purpose of the RICO treble damages provision is compensation but also recognized its important, but secondary, policing function. The Court concluded that the respondents could effectively vindicate both their Exchange Act and RICO claims in an arbitral forum and that there

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[2] Subsequently, in *Rodriguez de Quijas v. Shearson/American Express Inc.,* 490 U.S. 477, 109 S.Ct. 1917, 104 L.Ed.2d 526 (1989), this Court expressly overruled its prior decision in *Wilko*.

was no inherent conflict between arbitration and the purposes underlying the RICO treble damages provision.

In reaching its decision in this case, the Seventh Circuit acknowledged the principles driving this Court's decisions in the above-discussed cases, but, in reliance on this Court's decision in *Volt Information Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 109 S.Ct. 1248, 103 L.Ed.2d 488 (1989), apparently found that the New York prohibition against arbitral awards of punitive damages embodied in *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 386 N.Y.S.2d 831, 353 N.E.2d 793 (1976), was not inconsistent with the goals of the FAA and was not preempted by it. See *Mastrobuono v.*

Shearson Lehman Hutton, Inc., 20 F.3d 713, 716-717 (7th Cir. 1994), *cert. granted*, ___ U.S. ___, 115 S.Ct. 305, 130 L.Ed.2d 218 (1994). The Seventh Circuit's decision is, however, clearly at odds with the Congressional intent underlying the FAA and misconstrues and misapplies this Court's decision in *Volt*.

In *Garrity*, the New York Court of Appeals, in a closely divided decision, held that an arbitrator has no power to award punitive damages, even if agreed upon by the parties, and that enforcement of such an award would violate public policy. *Garrity*, 40 N.Y.2d at 357. The Court indicated that it was the exclusive province of the court or jury to award punitive damages (*Garrity*, 40 N.Y.2d at 358), and further stated, "The law does not and should not permit private persons

to submit themselves to punitive sanctions of the order reserved to the State." *Garrity*, 40 N.Y.2d at 360.

The decision in *Garrity*, however, represents precisely the type of careful vigilance which state courts extend to their jurisdiction which the FAA was expressly enacted to overcome with regard to "contracts evidencing a transaction involving commerce." The decision in *Garrity* is permeated with the misconceptions and prejudices against the arbitral forum which the FAA was enacted to defeat and which this Court has consistently refused to permit, even where such action meant overruling a prior decision which it found pervaded by "the old judicial hostility to arbitration." *Rodriguez*, 490 U.S. 477, 480 (1989), quoting from *Kulukundis Shipping Co. v.*

Amtorg Trading Corp., 126 F.2d 978, 985 (2nd Cir. 1942). In *Garrity*, the New York Court of Appeals plainly sought to withdraw the parties' ability to agree to an arbitral award of punitive damages, reserving solely to the judicial forum the power to award punitive damages, notwithstanding any contrary agreement by the parties.

In *Prima Paint*, *Keating* and *Perry*, this Court has consistently rebuffed similar attempts to limit arbitrability, finding them antithetical to the FAA and concluding that such parochial views of arbitration may not prevail over countervailing federal policy.[3]

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[3] The decisions in *Prima Paint*, *Keating*, and *Perry* clearly apply with equal force to state law of a judicial, common law origin. As the Court stated in *Perry*, 482 U.S. at 492, n. 9:

In considering the precise issue presented here, relying on the principles articulated in this Court's decisions in *Prima Paint*, *Moses H. Cone*, *Keating*, and *Mitsubishi Motors*, the First, Eighth, Ninth and Eleventh Circuits have all held that the FAA preempts state law prohibiting arbitral awards of punitive damages incorporated into an arbitration agreement by means of a state choice-of-law clause.[4]

> Nor may a court rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.

[4] In *J. Alexander Securities, Inc. v. Mendez*, 17 Cal.App.4th 1083, 1090-1091, 21 Cal.Rptr.2d 826 (Cal. Ct. App. 1993), *cert. denied*, ____ U.S. ____, 114 S.Ct. 2182, 128 L.Ed.2d 901 (1994), the

In *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6 (1st Cir. 1989), the First Circuit affirmed an arbitral award of punitive damages finding that the parties had agreed to submit all disputes arising out of their exclusive dealership contract to arbitration conducted according to the rules of the American Arbitration Association (hereinafter "AAA"). The First Circuit acknowledged that "the broad policies of the Federal Arbitration Act" governed its analysis and that the FAA expresses a strong federal

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California appellate court reached the same conclusion. In fact, in *Singer v. E.F. Hutton & Co., Inc.*, 699 F.Supp. 276 (S.D. Fla. 1988), the plaintiffs opposed the defendants' attempts to compel arbitration on the basis that they were entitled to punitive damages under some of their claims but that a New York choice-of-law provision prevented them from obtaining punitive damages in arbitration. The District Court compelled arbitration of all claims, finding that the FAA preempted the New York prohibition.

policy in favor of arbitration. *Raytheon*, 882 F.2d at 9. Using these considerations as the general context for its inquiry, the court further considered the fact that the arbitration clause contained in the parties' contract was "neither limited in its scope nor optional in its application" and the fact that it required arbitration to be conducted pursuant to the rules of the AAA, which "grant any remedy or relief which is just and equitable and within the terms of the agreement of the parties." *Raytheon*, 882 F.2d at 9-10. In light of the liberal construction which this Court has indicated should be accorded agreements to arbitrate (*Mitsubishi Motors*), the First Circuit concluded:

> [I]t would seem sensible to interpret the "all disputes" and "any remedy or relief" phrases to indicate, at a minimum, an intention to resolve through arbitration any dispute that

> would otherwise be settled in a court, and to allow the chosen dispute resolvers to award the same varieties of relief as a court would be empowered to award. *Raytheon*, 882 F.2d at 10.

Further, the court noted and approved the decisions of other jurisdictions which had held that a contract's choice-of-law provision does not require a reviewing court to determine whether arbitrators are empowered to award punitive damages by looking to the law of the chosen forum.

In its decision, the First Circuit made specific reference to this Court's decision in *Volt*. It found that the *Volt* decision did not alter its conclusions, distinguishing *Volt* on the basis that it involved the application of state *procedural* rules relating to arbitration, not the construction of the scope of an arbitration agreement.

Similarly, in *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S.Ct. 287, 126 L.Ed.2d 237 (1993), the Eighth Circuit affirmed an arbitral award of punitive damages in a dispute arising out of a brokerage customer agreement. On appeal, the Eighth Circuit framed the issue before it as "whether federal or state law applies in interpreting the arbitration clause in the agreement and in determining if arbitrators can award punitive damages." *Lee*, 983 F.2d at 885. The Eighth Circuit rejected the reasoning applied by the Seventh Circuit in this case, ruling that federal law, not state law, governed the issue. The court further noted that the parties had agreed that any arbitration would be conducted in accordance with the Rules of the AAA, that the Rules of the

AAA permitted awards of punitive damages, and that the FAA gives force to the Rules of the AAA. *See Lee*, 983 F.2d at 887-888.[5]

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[5] The Eighth Circuit had previously reached a similar conclusion in *Collins Radio Company v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972), wherein the plaintiff opposed defendant's attempts to stay the action brought in the District Court, asserting that the parties' contract contained a Texas choice-of-law provision and that the arbitration agreement was invalid under Texas law because it failed to conform with Texas statutory requirements. In affirming the District Court's order staying the District Court proceedings, the Eighth Circuit stated:

> [Section 2 of the FAA] plainly voids all doctrines of invalidity, unenforceability and revocability which apply only to arbitration agreements. The plain meaning of §2 is that federal courts are no longer to apply state statutes and decisions which limit arbitration agreements with rules not applicable to other agreements. *Collins*, 467 F.2d at 998.

In *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991), the Ninth Circuit affirmed an arbitral award of $1 million, rejecting the defendant's assertion that a New York choice-of-law provision contained in the parties' contract precluded an arbitration award of punitive damages. In this respect, the Ninth Circuit held that federal law, rather than New York state law, controlled and that federal law permitted arbitral awards of punitive damages. *Todd,* 943 F.2d at 1062-1063.

In reaching its decision, the Eleventh Circuit also made specific reference to this Court's decision in *Volt*. It found that the Court "merely said that it would not disturb a state court's factual determination that the parties to the contract in *Volt* intended

to invoke California arbitration rules." *Todd,* 943 F.2d at 1062, citing *Volt*, 109 S.Ct. at 1255.

In *Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988), the defendant argued that a panel of arbitrators lacked power under a brokerage customer agreement, containing a New York choice-of-law provision, to award punitive damages. The customer agreement at issue also contained a broadly worded arbitration clause and provided that arbitration was to be held in accordance with the rules of the Arbitration Committee of the Chamber of Commerce of the State of New York, the American Arbitration Association or the Board of Arbitration of the New York Stock Exchange, as selected by the plaintiffs. Relying on its earlier decision in

Willoughby Roofing & Supply Co. v. Kajima International, Inc., 598 F.Supp. 353, *affirmed*, 776 F.2d 269 (11th Cir. 1985), as well as this Court's decision in *Moses H. Cone*, the Eleventh Circuit concluded that any doubts concerning the scope of arbitrable issues were to be resolved in favor of arbitration and that the arbitrators could, upon remand, award punitive damages if they found that the facts warranted such an award.[6] The court reaffirmed the conclusions reached in *Willoughby*, stating:

> [A] choice of law provision in a contract governed by the Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it

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[6] Based on false testimony given in the arbitration by plaintiffs' expert, the court determined that remandment was necessary.

> does not deprive the arbitrators of their authority to award punitive damages. *Bonar*, 835 F.2d at 1387, citing *Willoughby*, 598 F.Supp. at 359.

In reaching its decision in this case, the Seventh Circuit rejected the decisions of the First, Eighth, Ninth and Eleventh Circuits, relying instead on its own prior precedent in *Pierson v. Dean, Witter, Reynolds, Inc.*, 742 F.2d 334 (7th Cir. 1984), and a construction of *Volt* which cannot be rationally related to other prior decisions of this Court.[7]

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[7] The Seventh Circuit's decision in this case accords with the decisions of the Second Circuit in *Fahnestock & Co. v. Waltman*, 935 F.2d 512 (2nd Cir. 1991), *cert. denied*, ___ U.S. ___, 112 S.Ct. 389, 116 L.Ed.2d 331 (1991), and *cert. denied*, ___ U.S. ___, 112 S.Ct. 1241, 117 L.Ed.2d 474 (1992), and *Barbier v. Shearson Lehman Hutton Inc.*, 948 F.2d 117 (2nd Cir. 1991).

It should, however, be noted that the Seventh Circuit's decision in this case appears to conflict with its own prior decision in *Commonwealth Edison Co. v. Gulf Oil Corp.*, 541 F.2d 1263 (7th Cir. 1976), wherein the defendants argued that

In *Volt*, this Court addressed whether the FAA preempted a provision of the

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because the parties' contract contained an Illinois choice-of-law clause, the Illinois Uniform Arbitration Act governed the contract and, under that Act, the question of the existence of an agreement to arbitrate was to be decided by the courts. The Seventh Circuit found that the FAA, rather than the Illinois Arbitration Act controlled, concluding:

> Parties are not free to burden the arbitration process under the Federal Act by adopting state law that shifts the determination of disputes from arbitrators to the courts. To allow parties to so contract would undermine the provisions of the Federal Act. Congress, in enacting the Federal Arbitration Act, exercised its power over admiralty and interstate commerce. Any arbitration contract involving one of those areas is governed by the Federal Act. To permit the parties to contract away the application of the Act by adopting state law to govern their agreement would be inconsistent with the Act itself and with the holding in *Prima Paint*. *Commonwealth Edison,* 541 F.2d at 1269.

California Arbitration Act which allowed a court to stay arbitration pending the resolution of related litigation. In *Volt*, the agreement between the parties contained a broad arbitration clause as well as a choice-of-law provision stating that the law of the place where the project was located, California, would govern. A dispute arose and Volt made a formal demand for arbitration. In response, Stanford filed an action against Volt in the California Superior Court, seeking recovery against Volt and two other companies with which it did not have arbitration agreements. Volt petitioned the Superior Court to compel arbitration of the dispute and to stay the state court litigation until the arbitration was complete. Stanford, on the other hand, moved to stay the arbitration, pursuant to

a provision of the California Arbitration Act which allowed a court to stay arbitration pending resolution of related litigation between a party to the arbitration agreement and third parties not bound by it "where there is a possibility of conflicting rulings on a common issue of law or fact." The California trial court granted Stanford's motion to stay the arbitration and denied Volt's motion. The California appellate court affirmed, noting that the FAA applied, that the FAA contained no provision permitting a stay of arbitration pending the outcome of related litigation involving third parties not bound by the arbitration agreement, but that by virtue of the choice-of-law clause, the parties had incorporated the California arbitration rules into their contract.

The California Supreme Court denied discretionary review.

In reaching its decision, this Court initially rejected Volt's contention that the California appellate court's decision was, in effect, a finding that Volt had waived its "federally guaranteed right to compel arbitration." *Volt*, 489 U.S. at 475. The Court also rejected Volt's contentions that the California appellate court's construction of the choice-of-law clause contained in the parties' agreement conflicted with the federal policy favoring arbitration and that the FAA preempted the California stay provision. *Id.*, at 476. With regard to the preemption issue, the Court explained that, "even where Congress has not completely displaced state regulation in an area, state law may nonetheless be

preempted to the extent that it actually conflicts with federal law - that is, to the extent that it 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" *Id.*, at 477, quoting from *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S.Ct. 399, 85 L.Ed. 581 (1941). The Court framed the preemption issue as whether application of the California procedural stay provision, in accordance with the terms of the arbitration agreement, would undermine the goals and policies of the FAA and concluded that it would not.

Contrary to the Seventh Circuit's interpretation, the decision in *Volt* does not abrogate preemption concerns relating to enforcement of arbitration clauses which also contain choice-of-law clauses. In *Volt*, the Court found that a state

court construction of an arbitration agreement to encompass state procedural rules did not offend §4 of the FAA because that provision provides "only a right to obtain an order directing that "arbitration proceed *in the manner provided for in [the parties'] agreement.*" *Volt,* 489 U.S. at 474-475, quoting from 9 U.S.C. § 4. [Emphasis in the original.] The Court further concluded that enforcement of state *procedural* rules which are not designed to inhibit arbitration do not offend the FAA, stating:

> There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration - *rules which are manifestly designed to encourage*

> *resort to the arbitral process* - simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any other policy embodied in the FAA. *Volt*, 489 U.S. at 476. [Footnote omitted; emphasis added.]

This Court's decision in *Volt* cannot be read, as the Seventh Circuit suggests, to hold that *substantive* state law restraints on the scope of an arbitrator's power which fundamentally subvert the federal substantive law of arbitrability, incorporated into an agreement by means of a choice-of-law clause, are not preempted by the FAA. In *Volt*, the Court made explicit what a number of its prior decisions alluded to, that is that the FAA has not completely preempted the entire field of arbitration and the states may supply procedural arbitration rules which "are manifestly designed to encourage resort to the arbitral process," provided

those rules do not "offend" the "substantive" provisions of the FAA.[8] The

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[8] In *Securities Industry Association v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), a trade association of securities broker-dealers successfully challenged Massachusetts state regulations which required, among other things, that broker-dealers not make execution of a pre-dispute arbitration agreement a non-negotiable precondition to opening a customer account, conspicuous disclosure that such a condition could not be made non-negotiable and a full written disclosure of the legal effect of a pre-dispute arbitration agreement. The First Circuit found in favor of the broker dealers and held that these regulations were preempted by the FAA, concluding that this Court's decision in *Volt* did not require a contrary result. In this regard, the First Circuit stated:

> But, the choice-of-law provision in *Volt* did not impinge the enforceability of the arbitral contract. The California regulation filled in an interstice in the FAA, whereas the regulations here at issue plainly undermine the presumption of validity that the Act meant to confer on arbitration contracts generally. *Securities Industry Association*, 883 F.2d at 1119. [Citations omitted.]

Court specifically noted that although the "substantive" provisions of the FAA, §§1 and 2, have been held to apply in state and federal courts, it had never held that §§3 and 4 of the FAA, "which by their terms appear to apply only to proceedings in federal court," are "nonetheless applicable in state court." *Volt*, 489 U.S. at 468, n. 6. In light of this acknowledgement, it is not at all surprising that the Court concluded that application by a state court of state law procedures, which were "manifestly designed to encourage resort to the arbitral process," are not preempted by the FAA. In fact, the Court noted:

> [W]e think the California arbitration rules which the parties have incorporated into their contract generally foster the federal policy favoring

> arbitration. As indicated, the FAA itself contains no provision designed to deal with the special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue included agreements to arbitrate. California has taken the lead in fashioning a legislative response to this problem, by giving courts authority to consolidate or stay arbitration proceedings in these situations in order to minimize the potential for contradictory judgments." *Volt*, 489 U.S. at 476, n. 5.[9]

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[9] The Court's views in this regard were anticipated in its prior decision in *Moses H. Cone*. In *Moses H. Cone*, the Court noted that under the FAA an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not the arbitration agreement. In this regard, the Court noted, "In some cases, of course, it may be advisable to stay litigation among the nonarbitrating parties pending the outcome of arbitration. That decision is one left to the district court (or to the state trial court under applicable state procedural rules) as a matter of its discretion to control its docket." *Moses H. Cone*, 460 U.S. at 20, n. 23. [Citation omitted.]

Similarly, in her dissenting opinion in *Keating*, Justice O'Connor (who was

The Seventh Circuit's decision, as well as the similar decisions from the Second Circuit, make no reference to the impact of their decisions on other factual scenarios whether impacting on punitive damages or any other issue determined to be unenforceable by arbitrators. Assume Mr. DiMinico's employment agreement with Shearson had a similar comprehensive arbitration agreement. Does that mean the punitive damages remedies in an age discrimination or disability action against Shearson are withdrawn from an arbitrator's consideration? Assume there

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joined in her dissent by Justice Rehnquist, the author of the majority's opinion in *Volt*), stated that the states should be afforded the opportunity to develop their own methods for enforcing "the new federal rights" which she viewed the majority's decision applying §2 of the FAA in state courts to create. *Keating*, 465 U.S. at 31-32 (O'Connor, J., dissenting).

are other states with "policy considerations" on compensatory awards for sexual harassment claims of employees. Do employees forgo those claims because of choice-of-law provisions inserted in the arbitration agreement by sophisticated employers?

On that subject, one can just imagine the search for states with favorable substantive precedent to fuel these agreements to the disadvantage of the consumers or investors who consider themselves safeguarded by the Federal Arbitration Act. The *Mastrobuono* decision does more than neutralize the value of the FAA; it serves to disadvantage the unsophisticated investor in favor of the sophisticated members of the securities industry.

Here, the "*Garrity* rule" which the Seventh Circuit found controlling, unlike the California procedural rules which the Court in *Volt* found promoted arbitration, is simply an antiquated remnant of "judicial hostility toward arbitration" which the FAA was expressly enacted to overcome. Moreover, unlike the procedural rules which the Court found were not preempted by the FAA in *Volt*, the incorporation of the New York rule prohibiting arbitral awards of punitive damages is clearly a substantive or outcome-determinative limitation on arbitrability.[10] This is clear from the

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[10] Here, the parties expressly provided that the arbitration was to be held "in accordance with the rules of the National Association of Securities Dealers, Inc. or the Boards of Directors of the New York Stock Exchange, Inc. and/or the American Stock Exchanged Inc. as [petitioners] may elect." (Pet. App. 44). The Seventh Circuit acknowledged

Garrity decision itself, wherein the New York Court of Appeals expressed the issue as a question of the scope of an arbitrator's power and the ability of contracting parties to define the scope of an arbitrator's authority, versus the realm of exclusive judicial authority. With regard to contracts evidencing transactions involving commerce, such an issue is clearly governed by the FAA. As this Court in *Volt*, reaffirmed:

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that the NASD Code Of Arbitration Procedure is "prescribed and adopted...for the arbitration of any dispute, claim or controversy," that the NASD Arbitrator's Manual provides that "[p]arties to an arbitration are informed that arbitrators can consider punitive damages as a remedy," and that NASD Rule of Fair Practice 21(f)(4) provides that "[n]o agreement shall included any condition which...limits the ability of the arbitrators to make any award," but concluded that the New York law prohibiting arbitral awards of punitive damages was controlling. (*Mastrobuono*, 20 F.3d at 717-718; Pet. App. 15-18).

> In recognition of Congress' principal purpose of ensuring that private arbitration agreements are enforced according to their terms, we have held that the FAA pre-empts state laws which "require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Volt*, 489 U.S. at 478-479. [Citations omitted.]

II.

PETITIONERS DID NOT WAIVE THEIR RIGHT TO RECOVER PUNITIVE DAMAGES FOR THE EGREGIOUS MISCONDUCT OF RESPONDENTS BY AGREEING TO A COMPREHENSIVE ARBITRATION CLAUSE AND A NEW YORK CHOICE-OF-LAW CLAUSE.

The Seventh Circuit went beyond the "*Garrity* rule" in its decision because *Garrity* did not expressly foreclose recovery of punitive damages in a judicial forum. The Seventh Circuit concluded not only that the Mastrobuonos' punitive damages claims were not arbitrable but also that they had waived *any* right to

recover punitive damages in *any* forum because, "[u]nder the plain language of the agreement, the [petitioners] are entitled only to the damages available in arbitration under New York law." *Mastrobuono*, 20 F.3d at 718. This principle manifestly disregards the longstanding federal goal of investor protection, which is evidenced in both the Securities Act of 1933 and the Securities Exchange Act of 1934, and presents the preposterous result of permitting broker-dealers to utilize the Federal Arbitration Act to exculpate themselves from the consequences of their egregious misconduct through the facially innocuous device of a New York choice-of-law clause in a contract which also contains a broad arbitration clause. The Seventh Circuit's conclusion in this regard is clearly

untenable; it fundamentally subverts the concept of waiver and renders the contract at issue unconscionable.

A waiver is a voluntary and intentional relinquishment of a known right. (*See, e.g., Johnson v. Zerbst,* 304 U.S. 458, 464, 58 S.Ct. 1019, 82 L.Ed. 1461 (1938); *Bonar v. Dean Witter Reynolds, Inc.,* 835 F.2d 1378, 1387-1388 (11th Cir. 1988)). In *Bonar*, the Eleventh Circuit correctly refused to find a waiver under circumstances essentially identical to those presented here, finding:

> As our previous discussion demonstrates, the customer agreement was far from a model of clarity on the subject of punitive damages. Paragraph 16, incorporating by reference the rules of the American Arbitration Association, allowed the arbitrators to "grant any remedy or relief which [they] deem[ed] just and equitable and within the scope of the agreement of the parties." Paragraph 17 provided that New

> York law would govern the agreement and its enforcement. *The agreement never explicitly mentioned punitive damages. Simply by signing such an ambiguous agreement, the appellees could not have intended to relinquish their right to punitive damages. Dean Witter's argument ignores the definition of waiver.* Bonar, 835 F.2d at 1388. [Citations omitted; footnote omitted; emphasis added].

The Seventh Circuit's decision ignores the definition of waiver, but is also predicated on an illogical analysis. As this Court has recognized, an arbitration clause is a special type of forum selection clause. See *Mitsubishi Motors,* 473 U.S. at 630. As such, it is designed to determine the forum in which disputes will be resolved but not to limit the substantive claims which the parties may assert in that forum. As this Court explained in *Mitsubishi Motors*:

> By agreeing to arbitrate a statutory claim, a party does not forgo the *substantive* rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum." *Mitsubishi Motors,* 473 U.S. at 628. [Emphasis added.]

See also, *Rodriguez,* 490 U.S. at 481. Accordingly, it cannot fairly be concluded, as the Seventh Circuit did, that in the absence of some explicit provision to the contrary, parties who have simply agreed to submit their claims to arbitration, including those giving rise to punitive damages, intended only a full adjudication of the substance of those claims but not a full adjudication of the remedies to which they may be entitled. As the First Circuit explained in *Raytheon*:

> [W]e agree that punitive damages can serve as an effective deterrent to malicious or fraudulent conduct. Where such

> conduct could give rise to punitive damages if proved to a court, there is no compelling reason to prohibit a party which proves the same conduct to a panel of arbitrators from recovering the same damages. Certainly, the fact that the parties agreed to resolve their dispute through an expedited and less formal procedure does not mean that they should be required to surrender a legitimate claim to damages. Parties that do wish arbitration provisions to exclude punitive damages claims are free to draft agreements that do so explicitly. In this case, no such exclusion from the general language of the arbitration clause exists. *Raytheon,* 882 F.2d at 12.

Moreover, construing the inclusion of a New York choice-of-law clause and a comprehensive agreement to arbitrate to result in a waiver of the petitioners' ability to recover punitive damages for the egregious misconduct of respondents renders the agreement unconscionable. As stated by Justice Blackmun in

Shearson/American Exp., Inc. v. McMahon, 482 U.S. 220, 261, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987) (Blackmun, J., concurring in part and dissenting in part):

> The uniform opposition of investors to compelled arbitration and the overwhelming support of the securities industry for the process suggest that there must be *some* truth to the investors' belief that the securities industry has an advantage in a forum under its own control. See N.Y. Times, Mar. 29, 1987, section 3, p. 8, col. 1 (statement of Sheldon H. Elsen, Chairman, American Bar Association Task Force on Securities Arbitration: "The houses basically like the present system because they own the stacked deck"). [Footnote omitted, emphasis in original].

The Seventh Circuit has endorsed the ability of a party with a superior bargaining position to "stack the deck" and, under the guise of an *explicit* predispute waiver of a judicial forum, to

which the parties certainly may agree, effectuate an *implicit* waiver of an existing right to recover punitive damages within that judicial forum. The only party benefitted by this "waiver" is the securities dealer and his firm, here, the respondents. Ironically, here, as is generally the case, the parties who imposed the arbitration clause and have compelled arbitration now seek to obviate the result of that arbitration, apparently realizing that the deck was not "stacked" as anticipated.

Unlike the situation presented in *Volt*, where the issue presented was the management of interrelated arbitral and judicial proceedings and a state's ability to regulate such proceedings in the absence of an applicable federal directive

on that issue,[11] the decision of the Seventh Circuit has construed the juxtaposition of an arbitration clause and New York choice-of-law clause to deprive the Mastrobuonos, and presumably any other investor, of *any* forum, arbitral or judicial, for determination of their punitive damages claims. The position articulated by respondents and adopted by the Seventh Circuit is simply that by agreeing to a choice-of-forum and with a choice-of-law clause, these investors have foreclosed themselves from any ability to recover punitive damages in any forum.

The usefulness of this "waiver by implication" precedent does not end with just punitive damages. One can hypothecate any number of similar issues

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[11] See *Volt*, 489 U.S. at 477, n. 6.

which choice-of-law provisions may obviate, depending on the state of choice, thereby increasing the prejudice to investors and the degree to which the deck can be stacked against them. And the vehicle utilized is, paradoxically, the Federal Arbitration Act.

This Court has previously stated that it would not countenance such a scenario. In *Mitsubishi Motors*, the Court declined to consider the potential effect of any refusal by the arbitral panel to recognize an American statutory cause of action under the Sherman Act, in light of a Swiss choice-of-law clause, on the claimant's ability to reinstitute suit in the federal court. The Court did, however, expressly note that "in the event the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a

party's right to pursue statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy." *Mitsubishi Motors,* 473 U.S. at 637, note 19. [Citations omitted.]

An analogous situation is presented here. Respondents assert that the choice-of-forum clause, the comprehensive arbitration clause contained in the parties agreement, together with the New York choice-of-law clause, operated as a prospective waiver of the Mastrobuonos' right to pursue punitive damages as a remedy for both their common law and statutory claims. Accordingly, even accepting the Seventh Circuit's construction of the parties' agreement as resulting in an implicit predispute waiver of the Mastrobuonos' right to recover

punitive damages, the agreement would be void as contrary to public policy.

CONCLUSION

For the foregoing reasons, petitioners respectfully request that this Court reverse the judgment of the Seventh Circuit Court of Appeals and remand this cause for confirmation of that portion of the arbitrators' award awarding petitioners punitive damages in the amount of $400,000 or, in the alternative, for a trial before the District Court on the amount of punitive damages or, in the further alternative, for a trial on petitioners' statutory and common law

claims giving rise to their claims for punitive damages.

Respectfully submitted,

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APPENDIX

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9 U.S.C. §2 provides:

Validity, irrevocability, and enforcement of agreements to arbitrate.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. §3 provides:

Stay of proceedings where issue therein referable to arbitration.

If any suit or proceeding be brought in any of the Courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. §4 provides, in relevant part:

Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination.

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement....The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement....

U.S.C. §10(a) provides:

Award of Arbitrators; vacation; grounds; rehearing.

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration -

(1) Where the award was procured by corruption, fraud, or undue means.

(2) Where there was evident partiality or corruption in the arbitrators, or either of them.

(3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.